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USTR FOR KATE DUCKWORTH  
NSC FOR RACHEL WALSH AND LUIS ROSSELLO

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SUBJECT: SEMINAR REVEALS WIDE SKEPTISM OVER PRE-SALT REGULATORY  
FRAMEWORK

REFERENCE: A. BRASILIA 1099  
[1](#)B. RIO DE JANEIRO 288

[1](#)1. (SBU) SUMMARY: In a conference entitled "Pre-salt Oil Risks and Opportunities," sponsored by Rio de Janeiro Federation of Industries (FIRJAN) on September 21, sitting and retired politicians, petroleum executives, and energy analysts debated the merits and deficiencies of the regulatory framework to develop the pre-salt oil reserves, released by the Brazilian government on August 31 (reftels). Though the speakers' perspectives may not have been universal, one persistent theme emerged: the conference participants believe that the newly proposed pre-salt regulatory regime will be more difficult to approve by the Brazilian Congress than the Brazilian Government expected. End Summary.

#### ROYALTIES

[1](#)2. (U) Paul Hartung (PMDB), the governor of Espirito Santo, stated Brazil's current concession model helped to both increase the rate of production of existing reserves and strengthen Petrobras. According to Hartung, the regulatory framework's proposal to extend royalties distribution to non-producing states and increase the federal government's share created a "war" between oil producing states, such as Rio de Janeiro, Espirito Santo, and Sao Paulo, and the rest of the country. Hartung said he doubted the framework would win Congressional approval, due to the royalties issue. The vice governor of Rio de Janeiro state, Luiz Fernando de Souza Pezao echoed Hartung's statements and called for the application of royalties on nuclear power generation. He also thanked the forty six Rio de Janeiro federal deputies and three senators who are in favor of maintaining the current distribution of royalties.

#### PRE-SALT AND PETROBRAS

[1](#)3. (U) Rio de Janeiro Senator Francisco Dornelles (PP) expressed doubts that Petrobras would have the financial resources to invest a minimum of 30 percent in the exploration of all blocks, as called for in the framework. Dornelles expressed his "personal opinion" that others in his party would also oppose the framework. Federal Deputy Arnaldo Chinaglia (PT - Sao Paulo), discounted this concern, however, stating it was unlikely that the GoB would not have assessed the volume of investment required - and Petrobras' ability to make such investments - prior to the announcement of the framework. The President of FIRJAN's Energy Council and former President of Petrobras Armando Guedes said the new model would prejudice Petrobras by needlessly overextending the company. "I do not think Petrobras' participation should be 100 percent," he said. "There has to be opportunities for subcontracting."

[1](#)4. (U) Jose Luiz Alqueres, president of the Rio de Janeiro

Commercial Association, opined that Petrobras' role as chief operator under the framework would distort the oil and gas equipment market by stymieing competition, with negative consequences for Brazilian and foreign suppliers alike.

#### PETROSAL

¶5. (U) The President of the Brazilian Petroleum, Gas and Biofuels Institute (IBP), Joao Carlos De Luca, expressed concern over how the role of Petro-Sal, created under the framework, will affect foreign investment. According to De Luca, Petrosal will have "total control" over the operational committees for any pre-salt exploration and production consortium, with rights to both a vote and a veto. This control would give the government disproportionate control over any block's development.

#### CREATION OF A SOVEREIGN FUND

¶6. (U) On the regulatory framework's proposal to create a "Sovereign Fund" to capture oil profits for social programs, FIRJAN's Armando Guedes said it was necessary to establish targets for certain sectors and use pre-salt oil revenues to invest in increasing the overall competitiveness of the country. He emphasized that part of this fund must be administered wisely in order to avoid "Dutch disease," a reference to the relationship between exploitation of natural resources and the decline of the manufacturing sector.

¶7. (U) Rio de Janeiro State Deputy Glauco Lopes (PSDB) is in favor of the creation of a sovereign fund and cited the example of the town of Maca, which is a beneficiary of the resources of the royalties from oil exploration. Thanks to royalties, Maca has made significant progress in the areas of education, health and

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infrastructure, he said. Energy specialist and Professor Edmar Almeida agreed with Lopes that it would be necessary to make investments in education and science/technology, but pointed out the need to save a large portion of the funds, as well.

#### FUTURE PRODUCTION

¶8. (U) Luiz Carlos Mendonga de Barros, former president of Brazilian development bank BNDES, predicted that pre-salt oil will not be exported. His statement was based on a study conducted by his brother, Economist Jos Roberto Mendonga de Barros, which showed that if Brazil maintained a projected annual growth of 4.5 percent between 2010 and 2020, domestic consumption will require total output from the pre-salt reserves.

#### COMMENT

¶9. (SBU) Though the speakers' perspectives may not have been universal, one clear theme emerged: the newly proposed pre-salt regulatory regime will be more difficult to approve in Congress than the Brazilian Government expected. Embassy Poloff and Econoff conversations with members of Congress indicate that even the opposition believes the government already has the votes in the Chamber of Deputies to pass the four bills that constitute the government's proposed regulatory regime. Passage will be much more difficult in the Senate, where the governing coalition faces a stronger, more united opposition bloc and will have to manage a thin majority that includes seven of the nine senators from Rio, Sao Paulo, and Espirito Santo. The government's response to the concerns addressed by federal legislators from oil-producing states in the seminar will be crucial to the legislation's ultimate success. Many of these concerns, among others, are finding their way into the Congressional debate, as evidenced by the over 800 proposed amendments to the bills. The real question seems to be what form the final product will take after all the political wrangling is over. End Comment.

¶10. (U) This cable has been coordinated with Embassy Brasilia.